

Message Text

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ACTION EA-09

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C O N F I D E N T I A L SECTION 1 OF 2 WELLINGTON 1502

STADIS////////////////////////////////////

EA ONLY FOR EA/EP

E.O. 11652: GDS
TAGS: PFOR, AMGT, XE, XP, ECON
SUBJECT: EAST ASIA ECONOMIC POLICY REIEW

REF: (A) WELLINGTON 1163, (B) STATE 073295

1. THOUGH THE ECONOMIC OBJECTIVES SET DOWN IN THE
DRAFT PARM SUBMITTED REFTEL A COVER PRINCIPAL US
ECONOMIC INTERESTS IN NEW ZEALAND THE FOLLOWING
ADDITIONAL COMMENTS ON THE ECONOMIC SITUATION FACING
NZ ARE SENT TO ASSIST IN THE ECONOMIC POLICY REVIEW.

2. IT IS EVIDENT THAT NEW ZEALAND IS
SUFFERING FROM WHAT IS INCREASINGLY IDENTIFIED AS A
STRUCTURAL ECONOMIC IMBALANCE. THERE APPEARS TO BE A
SECULAR DETERIORATION IN ITS TERMS OF TRADE. IT HAS
BEEN SUFFERING A LARGE AND PERSISTENT CURRENT
ACCOUNT DEFICIT SINCE 1974. THE NEED TO REVERSE THIS
SITUATION IS BECOMING INCREASINGLY URGENT.

3. COMPLICATING THE PROBLEM OF ESTABLIHSING A NEW
VIALE ECONOMIC BALANCE BETWEEN NEW ZEALAND AND THE
OTHER ECONOMIES OF THE WORLD IS THE LARGE AND GROWING
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BURDEN OF ITS INTERNATIONAL DEBT. STARTING UNDER THE
LABOUR GOVERNMENT IN 1974 NEW ZEALAND BEGAN BORROWING
ABORAD TO COVER ITS GROWING CURRENT ACCOUNT
DEFICIT. THE LABOUR GOVERNMENT BORROWED TO MAINTAIN
FULL EMPLOYMENT AND ISOLATE NEW ZEALAND FROM WHAT WAS
THOUGHT TEN TO BE A SHORT TERM CYCLICAL WORLD
ECONOMIC RECESSION. SINCE THE BEGINNING OF 1976 THE

NATIONAL GOVERNMENT HAS BORROWED TO GAIN TIME FOR ECONOMIC RESTRUCTURING IN ORDER TO BRING NEW ZEALAND'S INTERNATIONAL PAYMENTS AGAIN INTO BALANCE. THE POLICY OPTIONS FOR ECONOMIC RESTRUCTURING ARE LIMITED. SUCCESS OF GNZ'S EFFORTS DEPENDS IN GREAT PART ALSO ON THE INDIVIDUAL AND COLLECTIVE ECONOMIC POLICIES OF NEW ZEALAND'S PRINCIPAL TRADING PARTNERS, E.G. AUSTRALIA, THE US, THE EEC (INCLUDING ESPECIALLY THE UK) AND JAPAN. RESTRUCTURING TO DATE HAS RESULTED IN ADJUSTMENT DOWNWARD OF NEW ZEALANDERS' REAL INCOMES AND CONSUMPTION WHILE CHANGING THE IMPORT PATTERN AND, AT LEAST IN THE SHORT RUN, REDUCING IMPORTS OF CAPITAL EQUIPMENT AND MATERIALS FOR INDUSTRY PRODUCING FOR DOMESTIC CONSUMPTION WHILE ENCOURAGING EXPANSION OF EXPORT ORIENTED INDUSTRIES.

4. THE INCREASED PRICES NEW ZEALAND RECEIVED DURING 1976 FOR ITS PRINCIPAL EXPORTS, ESPECIALLY WOOL, BEEF AND LAMB, HELPED CONSIDERABLY TO REDUCE THE CURRENT ACCOUNT DEFICIT. HOWEVER, THOUGH GNZ IS EXPECTING THE GENERAL PRICE LEVEL OF THESE EXPORTS TO REMAIN WELL ABOVE THE 1975 LEVEL, PARTLY BECAUSE OF LIMITED ABILITY TO EXPAND THESE EXPORTS, CONTINUED HIGHER PRICES WILL NOT BE SUFFICIENT TO OVERCOME ITS CURRENT ACCOUNT DEFICIT. THE GOVERNMENT IS ESPECIALLY CONCERNED AT THE EXPORT OUTLOOK FOR DAIRY PRODUCTS, HISTORICALLY A LARGE CONTRIBUTOR TO FOREIGN EXCHANGE EARNINGS. THE LARGE EEC NON-FAT DRY MILK SURPLUS CONTINUES TO DEPRESS WORLD PRICES AND

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THIS REDUCES AN IMPORTANT SOURCE OF EXPORT RECEIPTS. THOUGH THE IMPORTANT UK MARKET FOR NZ BUTTER IS NOW ASSURED THROUGH 1980 (ALBEIT ON A DECLINING SCALE) AND HOPEFULLY THE EEC WILL AGREE TO ANOTHER PRICE INCREASE, THE FUTURE OF THE UK MARKET (NZ'S LARGEST) FOR CHEESE IS STILL NOT CERTAIN. FURTHERMORE, THE UK DUTY ON NZ LAMB RISES TO A FULL 20 PER CENT IN JULY (FROM NO DUTY IN 1973), THUS FURTHER REDUCING EARNINGS ON NEW ZEALAND'S PRINCIPAL EXPORT. DEVELOPING A LONG HOPE FOR STABLE AND GROWING JAPANESE MARKET, ESPECIALLY FOR BEEF APPEARS TO BE BEYOND NZ'S REACH FOR THE FORESEEABLE FUTURE.

5. WHEN THE HIGH AND RISING SHIPPING COSTS TO DISTANT MARKETS ARE ADDED TO THE ABOVE FACTORS THE OUTLOOK FOR SUSTAINED HIGH EARNINGS FROM NZ'S TRADITIONAL PASTORAL EXPORTS (WHICH STILL ACCOUNT FOR ABOUT 70 PER CENT OF ITS EXPORT RECEIPTS) IS NOT SO BRIGHT. HENCE, THE GROWING EMPHASIS ON (AND HOPE OF) INCREASED MANUFACTURED

EXPORTS TO SOLVE NZ'S PAYMENTS DEFICIT. BUT THERE IS A
REAL QUESTION AMONG A NUMBER OF INFORMED OBSERVERS
WHETHER THESE CAN INCREASE SUFFICIENTLY AND ON A
SUSTAINED BASIS TO MAKE UP FOR THE "SHORTFALL" IN
EARNING POWER OF ITS PASTORAL EXPORTS.

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C O N F I D E N T I A L SECTION 2 OF 2 WELLINGTON 1502

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6. ON THE IMPORT SIDE, THE PRICES HAVE CONTINUED TO
CLIMB SO RAPIDLY THAT DESPITE A 20 PERCENT DECLINE IN
IMPORT VOLUME IN 1976 IMPORT PAYMENTS CONTINUE TO RISE.
AND MANY OF THESE RISING IMPORT PRICES ALSO SHOW UP
SOONER OR LATER IN INCREASED PRODUCTION COSTS OF ITS
EXPORTS, INCLUDING PASTORAL PRODUCTS, AND MORE GENERALLY
EXERT UPWARD PRESSURE ON AN ALREADY UNSUSTAINABLY HIGH
INFLATION RATE. ONLY ABOUT 20 PER CENT OF NZ'S IMPORTS
ARE FOR DIRECT CONSUMPTION, SO FURTHER REDUCTION IN THE
VOLUME OF IMPORTS WILL BE INCREASINGLY DIFFICULT WITHOUT
AN ADVERSE EFFECT ON ECONOMIC ACTIVITY.

7. AS CAN BE APPRECIATED FROM THE ABOVE HIGHLIGHTS
OF THE ECONOMIC SITUATION FACING NZ, THE PRESSURES ON
THE GNZ TO TAKE ECONOMIC SHORT CUTS SUCH AS, E.G.
INCREASED IMPORT CONTROLS (OR EVEN POSSIBLE FURTHER
DEVALUATION?) TO CORRECT ITS PAYMENTS IMBALANCE
ARE STRONG. THERE ARE INDICATIONS THESE PRESSURES
MAY BE INCREASING.

8. PRIME MINISTER MULDOON HAS A FIGHTING SPIRIT AND
DISINCLINATION TO PANIC. THIS IS A STRONG FACTOR IN
ASSURING THAT NEW ZEALAND WILL TRY TO ADOPT SOUND LONG

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RUN MEASURES AND AVOID ACTION WHICH MIGHT MAKE IT SUBJECT TO BEING ACCUSED OF EXACERBATING THE INTERNATIONAL ECONOMIC SITUATION. HOWEVER, WITH THE NEXT GENERAL ELECTIONS SET FOR NOVEMBER 1978, THE NATIONAL GOVERNMENT WILL BE PRESSED TO SHOW BEFORE THEN REAL PROGRESS IN REESTABLISHING A BALANCE IN THE ECONOMY. TO ACCOMPLISH THIS NZ WILL NEED THE UNDERSTANDING AND SUPPORT ESPECIALLY OF ITS STRONGER INDUSTRIALIZED TRADING PARTNERS TO SMOOTH THE WAY AND TO MINIMIZE THE ECONOMIC REPERCUSSIONS ON NEW ZEALAND.

9. THOUGH NEW ZEALAND CONTINUES CONSTRUCTIVE PARTICIPATION IN VARIOUS INTERNATIONAL ECONOMIC FORA ITS PRIME NEED FOR RIGHTING ITS ECONOMY URGENTLY WILL NO DOUBT CONTINUE TO INFLUENCE POLICIES IT ADOPTS OR SUPPORTS IN THE MULTILATERAL ECONOMIC ORGANIZATIONS IF GNZ SHOULD FEEL ITS DIFFICULT ECONOMIC SITUATION IS NOT BEING DULY TAKEN INTO ACCOUNT BY ITS ECONOMICALLY STRONGER FRIENDS, IT MIGHT PROVE LESS INCLINED TO COOPERATE ON BROADER ISSUES OF GREATER CONCERN TO OTHERS. THE ASSURANCE OF SECURE AND STABLE EXPORT MARKETS FOR NZ'S MAIN EXPORTS, MARKETS FOR ITS INCREASING MANUFACTURED EXPORTS, THE AVAILABILITY OF LOAN FUNDS (INCLUDING THOSE FROM MULTILATERAL FINANCIAL INSTITUTIONS) TO BRIDGE BALANCE OF PAYMENTS DEFICITS AND A TAPERING OFF OF IMPORT PRICE INCREASES WILL ALL BE OF CRUCIAL IMPORTANCE TO THE SUCCESS OF NEW ZEALAND'S EFFORT DURING THE NEXT TWO YEARS TO RESTRUCTURE ITS ECONOMY.

10. IT IS INCREASINGLY EVIDENT THAT NZ CANNOT SOLVE ITS ECONOMIC PROBLEMS ENTIRELY ON ITS OWN NOR IS IT IN A POSITION TO PLAY A SIGNIFICANT LEADERSHIP ROLE IN DEVELOPING THE NECESSARY WORLD CONDITIONS FOR THE GROWTH OF THE TYPE OF OPEN TRADING AND FINANCIAL SYSTEM AND OTHER CONDITIONS IT NEEDS TO OVERCOME ITS
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PRESENT DIFFICULTIES. IF THE US HOPES TO COUNT ON THE CONTINUED FULL GNZ SUPPORT AND INITIATIVES IN SUCH AREAS AS ENERGY (EA/SLT), TRADE (INCLUDING REDUCTION OF TRADE RESTRICTIONS) COMMODITIES (AGREEMENTS, BUFFER STOCKS, COMMON FUND, ETC.), THE IFIS AND AID (ESPECIALLY IN THE SOUTH PACIFIC AND ASEAN AREAS) AS

WELL AS NORTH-SOUTH AND EAST-WEST ISSUES NOT INCLUDED
ABOVE, TO THE EXTENT OUR BROADER ECONOMIC POLICY
COMMITMENTS ALLOW, WE SHOULD TAKE INTO ACCOUNT NZ'S
PRESENT ECONOMIC PROBLEMS AND WHERE INDICATED ENCOURAGE
ACTIONS BY OTHER COUNTRIES SUPPORTIVE OF NZ'S EFFORTS
AND IN ANY CASE WE SHOULD AVOID INITIATIVES WHICH COULD
EXACERBATE NZ'S ECONOMIC POSITION.
KILLGORE

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